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Research Report – Update

Investors should consider this report as only a single factor in making their investment decision.

Intellinetics Inc.

Speculative Buy

Howard Halpern

August 22, 2019

INLX $0.13 — (OTC)

	2016 A	2017 A	2018 A	*2019 E*	*2020 E*
Revenue (in millions)	$2.6	$2.6	$2.4	***$2.4***	***$3.2***
Earnings (loss) per share	($0.09)	($0.08)	($0.13)	***($0.12)***	***($0.10)***

52-Week range	$0.14 – $0.08	Fiscal year ends:	December
Shares outstanding a/o 08/13/19	18.5 million	Revenue/shares (ttm)	$0.14
Approximate float	8.5 million	Price/Sales (ttm)	0.9X
Market Capitalization	$2.4 million	Price/Sales (2020) E	0.8X
Tangible Book value/shr	($0.30)	Price/Earnings (ttm)	NMF
Price/Book	NMF	Price/Earnings (2020) E	NMF

Intellinetics Inc., headquartered in Columbus, OH, has developed IntelliCloud™, a software solutions platform enabling customers to capture and manage documents across its operations. IntelliCloud is a secure document management solution for organizations that have critical document requirements such as for audit trails and credentialing. The company's primary targets are organizations and governmental agencies within the health and human services and education (K - 12) markets.

Key Investment Considerations:

Maintaining our Speculative Buy rating and 12-month price target of $0.20 per share.

Intellinetics' IntelliCloud software solutions platform has growth potential within the records management services segment of the $5.3 billion document management services (DMS) industry. According to IBISWorld, the records management segment generated 2018 revenue of nearly $4 billion within the DMS industry. IBISWorld projects the industry to reach nearly $4.2 billion by 2024.

In 2Q19, INLX introduced a new Document Scanning Services™ business that is focused on accelerating the paper-to-digital transition for existing and new customers. Its first significant contract was for nearly $175,000 with the Franklin County Board of Developmental Disability.

In June 2019, the company announced a partnership with CaraSolva, Inc., a software developer of electronic based scheduling and administration applications for patient medications. The partnership should enable CaraSolva to add fully integrated document management capabilities within their MedSupport® eMAR solution for nursing and caregiver functions.

In 2Q18, INLX reported (on 8/14/19) a loss per share of ($0.03), on sales of $641,000 compared to a loss of ($0.04) per share on sales of $550,000 in 2Q18. We projected a loss per share of ($0.03) on sales of $590,000.

For 2019, we project a loss of ($0.12) per share on 2.3% revenue growth to $2.4 million. We previously projected a loss of ($0.13) per share on revenue of $2.4 million. Our forecast reflects 1H19 results.

For 2020, we project a loss of ($0.10) per share on revenue growth of 31.6% to $3.2 million (unchanged). Our forecast reflects over 50% growth in SaaS sales to $1.4 million.

We anticipate the company is likely to need additional capital to sustain and grow operations through the end of 2020. Our forecast includes the company raising approximately $300,000 of additional capital.

Please view our Disclosures on pages 15 – 17.

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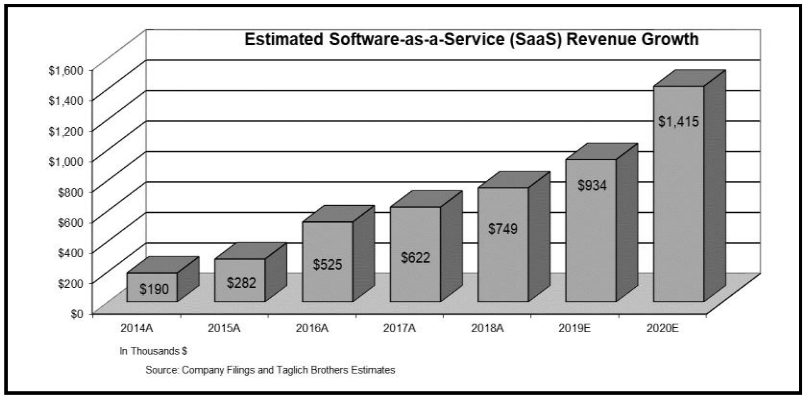
Appreciation Potential

We are maintaining coverage of Intellinetics Inc. with a Speculative Buy rating and 12-month price target of $0.20 per share.



Our rating reflects the company's estimated growth from its Software-as-a-Service (SaaS) model for the IntelliCloud software solutions platform. We project annualized growth of 39.7% to $1.4 million in 2020 (see chart on right) from 2014. Supporting our growth forecast should be the company's ability to gain customers in the K-12 education market through the August 2018 partnership with Software Unlimited, and the newly introduced new Document Scanning Services business. Management anticipates its partnership and new service offering should provide consistent revenue growth to 2020.

Our 12-month price target is $0.20 per share. We estimate 2020 sales per share of $0.17 based on 18.5 million shares outstanding from total sales of $3.2 million including SaaS revenue. Our share count estimate does not include the potential issuance of at least half of the 36.3 million shares of common stock reserved for the exercise of outstanding warrants, convertible notes, and stock options. According to MSN Money, the average trailing price-to-sales multiple for the Software/Information Technology industry is 4.4X (unchanged). INLX's trailing price-to-sales multiple is 0.9X (unchanged). We anticipate (based on forecasted SaaS revenue growth of over 50% in 2020 versus industry growth of 13.2%) investors could accord INLX a price-to-sales multiple approaching the industry, significantly offset by a higher discount factor accounting for potential dilution from the convertible debt due in 2020. We applied a multiple of 2X (unchanged) to our 2020 sales per share forecast of $0.17, discounted by 40% (accounting for execution and dilution risks) to obtain a year-ahead value of approximately $0.20 per share.

Intellinetics Inc. valuation is likely to remain at a discount relative to the industry due to lack of profits, financing costs, and the potential dilution from convertible financings, most of which mature in December 2020. Valuation improvement is likely to be gradual and contingent upon consistent annual SaaS revenue growth, expense leverage, and a narrowing of the company's cash burn and EBITDA losses. We forecast Intellinetics to have an adjusted EBITDA loss of $534,000 in 2019, an improvement from a loss of $1.2 million in 2018. In 2020, the EBITDA loss should narrow to $227,000. We are forecasting operating losses for 2019 and 2020 of $1.2 million and $827,000, respectively, with cash burn of $1.4 million in 2020.

In our view, Intellinetics Inc. is most suitable for high-risk tolerant investors seeking exposure to a microcap technology company that is attempting to build a solid SaaS recurring revenue customer base.

Overview

Intellinetics Inc., headquartered in Columbus, OH, has developed a software solutions platform (IntelliCloud) that allows customers to capture and manage documents across its operations. IntelliCloud is a secure document management solution for organizations that have critical document requirements such as for audit trails and credentialing. The company is targeting organizations and governmental agencies (state and local) within the health and human services and K-12 education market initially in the Midwestern US states.

IntelliCloud, is cloud computing enabled technology based on 20 years development in partnership with Intel. While the direct sales and marketing initiatives should be the primary growth driver through our forecast period, the company could still derive sales from its channel partners.

The IntelliCould software solution platform enables customers to capture and manage documents across operations such as scanned hard-copy documents and digital documents, images, audio, video and emails that is secure and compliant to a customer's industry regulation, as well as being continually backed-up to avoid data loss.

History
Intellinetics, Inc., (fka GlobalWise Investments, Inc.), is a Nevada holding company incorporated in 1997, with a single operating subsidiary, Intellinetics, Inc., an Ohio corporation. Intellinetics Ohio was incorporated in 1996, and on February 10, 2012, Intellinetics Ohio became the sole operating subsidiary of Intellinetics as a result of a reverse merger and recapitalization.

Recent Developments

In May 2019, INLX announced it began to collaborate with SkyNet Managed Technology Services, a provider of tailored IT services and solutions for small and medium-sized businesses. The aim of the company's collaboration with SkyNet is to increase efficiencies and reduce risks for its clients. Intellinetics will utilize SkyNet, in conjunction with Amazon Web Services to scale and provide customers the ability to embed additional hosting, security, and managed services within any of the company's cloud offerings.

In June 2019, the company announced a partnership with CaraSolva, Inc., a software developer of electronic based scheduling and administration applications for patient medications. The partnership should enable CaraSolva to add fully integrated document management capabilities within their MedSupport eMAR solution for nursing and caregiver functions.

IntelliCloud™ Solutions Platform

IntelliCloud customers can obtain use of the offering by either purchasing for installation onto their equipment, or by accessing the platform through a cloud-based software-as-a-service (SaaS) model. The company anticipates the SaaS model will increase and become a growing priority in the market for customers and should represent the most significant strategic part of INLX's revenue growth opportunities. The IntelliCloud software solutions platform is a Windows application that can have unlimited downloads and installs, enabling customers secure access even from remote locations. The platform has in excess of 50 pre-configured industry solutions ready for deployment. The primary modules of IntelliCloud include Capture, Gateway, Storage, and Desktop.

The capture component enables all network-scanned capable multi-function devices (MFDs) to route documents directly to the IntelliCloud platform. The capture technology enables customers to customize scan–to-network documents directly to gateway department specific soft-keys (a button or key that is preprogrammed) sending documents to unique workflows, as well as providing optional image processing, analysis, and data extraction.

The gateway mini-computer powered by an Intel chip can support hundreds of single and MFDs and enables the solution to securely route encrypted documents to storage. The gateway can also provide support for additional data streams such as enterprise resource planning information systems and fax streams. The platform's storage enables documents and data to be stored securely in the cloud and on-site along with comprehensive data backup protection that is provided 24/7/365.

IntelliCloud's modules include AuditShield™, Records management, and Workflow. AuditShield supports compliance and audit-readiness by identifying missing documents through a comprehensive exception-reporting engine. Records management addresses customer needs relating to long-term retention of content ensuring legal, regulatory and industry compliance. Workflow supports business processes, routing content electronically, assigning work tasks and states (e.g., reviews or approvals), and creating related audit trails.

Document Management Market

According to IBISWorld, the Document Management Services industry should reach $5.6 billion in 2024, up from and estimated $5.3 billion in 2018. The industry is divided into companies that provide commercial and government clients with outsourced records storage, document destruction services and digital conversion of paper-based records. The growth in the industry reflects increasing regulatory requirements mandating the retention of company records. Operators in the industry, such as Intellinetics, should benefit from sustained demand for secure document storage in electronic form.

IBISWorld estimates records management services segment revenue should reach $4.4 billion in 2024, up from an estimated $4.2 billion in 2018 (forecast assumes that 74.9% of the segment remains through 2022. One of the primary drivers of industry and segment growth is the increasing demand for digital conversion services. Industry participants estimate that only 1% of stored paper documents have been converted into digital files. In the next five-years, industry operators anticipate the digital conversion of medical records should be a significant growth opportunity.

Additional industry growth drivers include overall economic growth, stricter records management required by various governmental and industry regulatory authorities, as well as records requirements for potential litigation. Companies within the industry must provide a platform that is cost-effective and secure for outsourcing document and record management.

Industry solutions for large business organizations tend to be designed to integrate document management systems with real-time data that enables tracking the changes done in a document and storing different versions of the same document. The solutions offered within the industry can provide a secure location for storing electronic documents and indexing them for the quick retrieval of a particular version of the document.

Customers seeking a document management solution have begun to embrace a hybrid deployment model that allows an organization to move their most vital data to a private cloud without compromising on security and their non-sensitive data to a public cloud. Analysts estimate this is likely to be the fastest-growing segment over the next five years due to the flexibility, technical control, enhanced security, and adherence to the compliance requirements it offers.

Sales growth in North America reflects increasing demand for cost-effective and efficient business process solutions, as well as dealing with high infrastructure costs, strict policies, and increased regulatory framework.

Growth Strategy

The company aims to accelerate adoption of its IntelliCloud software solutions platform through partnerships. In 2018, INLX announced a partnership with software publisher Software Unlimited, Inc. (SUI), a software developer and publisher of solutions for the K-12 education market. In 4Q18, INLX's offering was fully integrated into SUI's K12docs document management offering. Customers who are early adopters will be able to use INLX's technology within SUI's School Accounting System to help districts of all sizes retain electronic documents efficiently, as well as provide a flexible electronic filing structure that will make storage, archival and retrieval of documents easier, and allow for compliance with state mandated retention policies. In December 2018, the company reported that the integrated offering was implemented at 11 pre-launch beta customers.

Management anticipates it will be able to obtain additional relationships with other segment leaders in order to grow its recurring revenue customer base.

The company aims to internally develop direct sales and marketing initiatives primarily for organizations and governmental agencies within the health and human services and K-12 education market in order to build IntelliCloud's customer base and recurring (SaaS) revenue.

Source: Company

The human services profession is one that promotes improved service delivery systems by addressing not only the quality of direct services, but also by seeking to improve accessibility, accountability, and coordination among professionals and agencies in service delivery. Some of Intellinetics' customers in this sector (listed in the chart on the right) are primarily in the Developmental Disability space. To further its efforts in human services, the company launched a provider portal in 2018. The portal is designed to provide a cost-effective solution enabling independent human services providers (a self-employed person providing services to people with developmental disabilities) to get up and running with Intellinetics document management solution within 24 hours.

INLX is striving to add customers in at least 60 of the 88 counties in the state of Ohio primarily with county government agencies and associated organizations providing services to people that are disabled. Near-term growth is substantial (thousands of potential customers) as INLX attempts to replicate and broaden its operations in five surrounding states in the Midwest.

The five additional states in the Midwest have a combined total of 448 counties, each with numerous agencies dedicated to support people that need help. The number of counties and agencies within those counties is just one potential set of customers for the IntelliCloud software solution platform. The second set of potential customers is an organization that has direct dealings with agencies that obtain funding, payment, or credentialing for services provided or to be provided. Having a unified set of document records would benefit all parties involved in the overall process of assisted people. A third set of potential customers within Midwestern states (including Ohio) are educational institutions primarily K-12. We estimate there are in excess of 3,900 school districts that manage approximately 16,000 schools in six Midwestern US states.

Projections

Basis of Forecast

Our forecast reflects an increase in customers utilizing the company's SaaS revenue model. We project an incremental increase in SaaS-based customers of at least 350 through December 31, 2020. If achieved, with some attrition expected, SaaS revenue could increase 24.7% in 2019 to $934,000 and 51.5% in 2020 to $1.4 million.

During our forecast period to 2020, we anticipate maintenance services approaching $1.1 million, up from $995,000 in 2018. Professional services revenue could increase to $600,000 in 2020, up from $290,000 in 2018 due to customers seeking product customization and customer acceptance of its document scanning services business launched in April 2019. Acceptance of INLX's document scanning services began in April 2019 with its first significant contract for nearly $175,000 with the Franklin County Board of Developmental Disability. Our software sales forecast is $29,000 and $80,000, respectively, in 2019 and 2020. We project third party services remaining relatively low at $38,000 and $60,000 in 2019 and 2020, respectively. One or two large customers could significantly increase software revenue. However, software revenue could fall short of expectations if customers fail to sign agreements.

We anticipate 2019 and 2020 gross margins of approximately 77.3% and 76.3%, respectively, up from 68.8% in 2018 due primarily to expanding SaaS margins to 71.8% and 72.4%, in 2019 and 2020, respectively, from 59.9% in 2018. SaaS revenue growth should enable the company to leverage operations with minimal incremental cost of sales. However, the slight decrease in 2020 gross margin reflects an unusually high margin in 2Q19 for the company's professional services offering, that is unlikely to be repeated in 2020.

2019

We project total revenue growth of 2.3% to $2.4 million (unchanged) due primarily to a 24.7% increase in recurring SaaS sales to $934,000 reflecting at least 125 new customers (net of attrition), a 49.7% increase in professional services to $434,000 due primarily to incremental revenue from its document scanning service offering and a modest increase in customer requests for customization, and a $5,000 increase in software maintenance service fees to $1 million as the signing of new contracts and existing customer renewals are virtually flat with non-renewals. We anticipate decreases in third party services and the sale of software by $133,000 and $145,000, respectively due to fewer projects and the move toward the company's SaaS offering.

We project a 14.8% increase in gross profit to $1.9 million due to sales growth and gross margin expansion to 77.3% from 68.8% in 2018. The operating loss should narrow $284,000 to $1.2 million due to operating expense margin improving to 126.1% from 131% in 2018. We anticipate operating expenses of nearly $3.1 million, down by $41,000 from 2018. We project a $48,000 decrease in sales and marketing expense to $950,000 reflecting 1H19 results and G&A expense virtually flat at $2.1 million.

We project interest expense increasing to $967,000 from $866,000 due to higher convertible debt outstanding. We forecast a net loss of $2.2 million or ($0.12) per share compared to $2.3 million or ($0.13) per share in 2018. Our previous net loss forecast was $2.5 million or ($0.13) per share.

2020
We project total revenue growth of 31.6% to $3.2 million (unchanged) due primarily to a 51.5% increase in recurring SaaS sales to $1.4 million reflecting at least 225 new customers (net of attrition), a 5% increase in software maintenance service fees to nearly $1.1 million as the signing of new contracts and existing customer renewals exceeds non-renewal of contracts, and a $166,000 increase in professional services to $600,000 due to increasing customization work and customer acceptance of its document scanning services business. We anticipate software sales and third party services to $80,000 and $60,000, respectively, compared to $29,000 and $38,000 in 2019.

We project a 30% increase in gross profit to $2.4 million due primarily to sales growth. Gross margin is likely to contract slightly to 76.3% from 77.3% in 2019. The operating loss should narrow to $827,000 from $1.2 million in 2019, as we forecast operating expense margin improving to 102.2% from an estimated 126.1% in 2019. We anticipate a $201,000 increase in operating expenses to nearly $3.3 million with G&A and sales and marketing expenses increasing $105,000 and $100,000, respectively, to $2.2 million and $1.1 million. D&A expense should decrease to $4,000 from $8,000 in 2019.

We project interest expense increasing to $1.1 million from $967,000 due to a higher debt balance. We forecast a net loss of $1.9 million or ($0.10) per share. We previously forecasted a loss of $2.1 million or ($0.12) per share.

Finances
In 2019, we project cash burn of $1.5 million and a decrease in working capital of $569,000 due primarily to increases in other long-term liabilities and payables. Borrowings will not cover cash used in operations of $908,000 and capital expenditures, reducing cash by $860,000 to $229,000 at December 31, 2019.

In 2020, we project cash burn of $1.4 million and a decrease in working capital of $1 million. The decrease in working capital is due primarily to increases in deferred revenue, other long-term liabilities, and payables. Borrowings of $200,000 is unlikely to cover cash used in operations of $329,000 and capital expenditures, decreasing cash by $184,000 to $44,000 at December 31, 2020.

The company is likely to need to borrow at least $300,000 in funds in order to maintain its sale and marketing initiative to build a direct sales model through 2020.

2Q19 and 1H19 Results

2Q19
Total revenue increased 16.5% to $641,000 compared to $550,000 in the year-ago period due primarily to a 29.2% increase in Software-as-a-Service (SaaS) product offerings to $230,000 and nearly a tripling in professional services sales to $143,000 from $53,000 in 2Q18. The increase in SaaS revenue reflects new customers choosing a cloud-based solution, as well as an incremental benefit from expanded data storage and hosting fees. Professional services increased due primarily to the timing of consulting contracts for customers seeking additional customization, project management, and training, as well as growth in its newly formed (April 2019) document scanning services segement. Maintenance services sales increased $8,000 to $253,000 due primarily to price increases exceeding attrition of existing maintenance agreement renewals.

Partly offsetting the increase in total revenue were a combined $53,000 in reductions of software sales and third party services. The decrease in software sales to $7,000 from $34,000 was due to a market shift toward SaaS sales. The decrease in third party service revenue to $8,000 from $40,000 reflects the timing of new projects.

Gross profit decreased $121,000 to $511,000 due to higher sales and gross margin improvement to 79.7% from 71% in 2Q18. Gross margin reflects improvement in SaaS and professional service margins.

Operating expenses decreased to $745,000 from $840,000 in 2Q18. G&A expense decreased $72,000 to $521,000 due to lower professional fees for consulting, obtaining a training grant, as well as reduced payroll from headcount reduction. Sales and marketing expense decreased $22,000 to $222,000 reflecting the outsourcing certain marketing functions. D&A expense remained flat at $2,000.

Interest expense increased to $239,000 from $219,000 in the year-ago period due to higher debt levels and the amortization of debt issuance costs associated with the issuance of notes payable in September 2018.

The net loss was $474,000 or ($0.03) per share compared to a net loss $669,000 or ($0.04) per share in 2Q18. We projected a loss per share of ($0.03) on sales of $590,000.

1H19

Total revenue increased 7.5% to $1.2 million. The increase was due primarily to increasing demand for the company's professional services and SaaS offering. The revenue increase was restrained by lower software, and third party service sales.

Gross profit increased 15% to $883,000 due to higher sales and gross margin expansion to 76.4% from 71.4% in the year-ago period.

Operating expenses decreased 5.6% to $1.6 million due primarily to a $16,000 decline in sales and marketing expenses to $490,000 and a $76,000 decrease in G&A expense to $1.1 million.

In Thousands $	6 Mos. '19	6 Mos. '18	% D
Total revenue	$ 1,156	$ 1,075	7.5%
Cost of sales	273	307	(11.3%)
Gross Profit	883	768	15.0%
Total Operating Expenses	1,554	1,648	(5.6%)
Operating Income (loss)	(671)	(880)	NMF
Total Other Income (expense)	(472)	(428)	NMF
Pre-Tax Income (loss)	(1,144)	(1,308)	NMF
Income Tax Expense (Benefit)	-	-	
Income from continuing ops.(loss)	(1,144)	(1,308)	NMF
Earnings per share	$ (0.06)	$ (0.07)	
Avg Shares Outstanding	18,503	17,724	
Margin Analysis			
Gross margin	76.4%	71.4%	
Operating margin	(58.0%)	(81.8%)	
Pre-tax margin	(98.9%)	(121.7%)	

Source: company reports

Interest expense was $472,000 compared $428,000 in the year-ago period. The net loss was $1.1 million or ($0.06) per share compared to a net loss of $1.3 million or ($0.07) per share in the year-ago period.

Finances

In 1H19, cash burn of $775,000 and a decrease in working capital of $127,000 resulted in cash used in operations of $648,000. The decrease in working capital was due primarily to increases in other liabilities and payables and accruals. Cash used in operations and repayment of notes payable reduced cash by $676,000 to $412,000 at June 30, 2018.

Capital Structure

At June 30, 2019, the company had total debt on its balance sheet of $4.3 million. The debt is comprised of $3.2 million in long-term notes and long-term related party notes of nearly $1.1 million, and $24,000 in short-term related party notes.

At June 30, 2019, total outstanding notes payable - related party was $1.1 million (excludes $24,000 of unamortized debt issuance costs) consisting of nearly $24,000 on a Shealy note that the company repays in monthly installments through January 1, 2020, $345,000 of convertible notes, $390,000 of convertible notes, and $400,000 of convertible notes all maturing in December 2020.

On September 17, 2018, $345,000 of convertible notes was amended to mature on December 31, 2020, and bear interest at an annual rate of 10% until maturity, with partial interest of 5% payable quarterly. The amendment provides note investors the ability to convert the notes into shares at a conversion rate of $0.40 per share.

On September 14, 2018, $390,000 of convertible notes was amended to mature on December 31, 2020, and bear interest at an annual rate of 8% until maturity, with partial interest of 8% payable quarterly. The amendment allows note investors to convert the notes into shares at a conversion rate of $0.20 per share.

On September 26, 2018, the company issued convertible promissory notes in an aggregate amount of $400,000 to accredited investors, including Robert Taglich and Michael Taglich (each holding more than a 5% beneficial interest in Intellinetics Inc.). The notes mature on December 31, 2020, and bear interest at an annual rate of 8% payable quarterly beginning January 2, 2019. The note investors have a right to convert the notes into shares under certain circumstances at a conversion rate of $0.13 per share.

At June 30, 2019, total non-related party debt (including a reduction of $216,000 of unamortized issuance costs) was $3.2 million consisting of an outstanding balance of $799,000 of convertible promissory notes. On September 17, 2018, the convertible notes were amended to mature on December 31, 2020, and bear interest at an annual rate of 10% until maturity, with partial interest of 5% payable quarterly. The amendment provides note investors the ability to convert the notes into shares at a conversion rate of $0.40 per share.

In November 2017, the company issued nearly $1.8 million in convertible promissory notes. On September 14, 2018, the convertible notes were amended to mature on December 31, 2020, and bear interest at an annual rate of 8% payable quarterly. The amendment provides note investors the ability to convert the notes into shares at a conversion rate of $0.20 per share.

In September 2018, the company issued $900,000 in convertible promissory notes that mature on December 31, 2020, and bear 8% annual interest payable quarterly beginning January 2, 2019. The note investors have a right, at their sole discretion, to convert the notes into shares at a conversion rate of $0.13 per share.

Competition

The market for the company's IntelliCloud software solutions platform is highly competitive with competition likely to intensify as the document solutions market evolves. The market is highly fragmented with the US having a large number of small companies servicing local or regional markets.

The competitive factors affecting the document solutions market include reputation, quality, performance, and price, as well as the availability of software products on multiple platforms, product scalability and integration with other enterprise applications. Additional competitive factors that Intellinetics' solutions are likely to face include the ability to effectively store, manage, and retrieve client records. In this market, companies are responsible for handling client's highly confidential records; thus having a reputation for reliability and security is crucial in order to obtain and retain customers.

The company believes its primary competitors within the small-to-medium business sector are private companies including DocuWare, Square 9, and M-files.

Risks

In our view, these are the principal risks underlying the stock.

<u>Going Concern</u>
INLX has yet to turn profitable. At June 30, 2019, the company's accumulated deficit was over $19.8 million, up from nearly $15 million in 2016. Losses are likely to continue to be substantial through our forecast period. The lack of profitability could result in the company's inability to execute its growth strategy and/or seek dilutive financing. These factors raise substantial doubt from the company's auditor about its ability to continue as a going concern.

<u>Dilution</u>
Intellinetics Inc. is likely to need additional capital in order to execute its business plan. At June 30, 2019, the company anticipated at its current rate of growth, there will be a shortfall in meeting its monthly cash requirements. A sustained monthly shortfall would likely necessitate future financings, which is likely to dilute existing shareholders.

Over the six-year period ended December 31, 2018, the company raised $12.7 million through the issuance of debt and equity securities.

At June 30, 2019, the company has more than 36.3 million shares reserved for the issuance of stock upon the exercise of outstanding warrants, convertible notes, and outstanding stock options, as well as shares reserved for the company's equity incentive plan.

Customer Concentration

In 2018 and 2017, government contracts represented approximately 30% and 41% of net revenues, respectively. A significant portion of the company's sales to resellers represents ultimate sales to government agencies. In 2Q19, the company's four largest customers represented 49% of gross accounts receivable, compared to its four largest customers representing 66% of gross accounts receivables in 2018. The loss of a significant customer could disrupt the company's operations.

Internal Controls

Material weaknesses in internal controls as of June 30, 2019 include insufficient segregation of duties consistent with control objectives. Any material weakness or unsuccessful remediation could affect Intellinetics' ability to file periodic reports on a timely basis and investor confidence in the accuracy and completeness of financial statements, which could adversely effect the ability to raise additional funds.

Intellectual Property

Since software and most of the underlying technologies are built on a Microsoft.Net framework, Intellinetics must rely on a combination of copyright, trademark laws, non-disclosure agreements, and other contractual provisions to establish and maintain proprietary intellectual property rights. Loss of such rights could adversely impact operations and growth prospects.

Infringement

Claims of infringement are becoming commonplace within the software industry. While the company does not believe it infringes on the rights of third parties, a third party may assert Intellinetics software violates their intellectual property rights.

Cyber Security

Security breaches, unauthorized access and usage, viruses or similar types of breaches or disruptions could result in loss of confidential information, damage to the company's reputation, early termination of contracts, litigation, regulatory investigations, etc. If the company's security measures or its third-party data centers are breached as a result of third-party action, employee error, or malfeasance, its business could diminish due to the potential for significant liability expenses.

The US has laws and regulations relating to data privacy, security, and retention and transmission of information. The company must protect its information systems against unauthorized access and disclosure of confidential information and confidential information belonging to customers. The company believes it has policies and procedures in place to meet data security and records retention requirements. However, there is no assurance that the security measures in place will be effective in every case.

Market Acceptance

The markets for the company's IntelliCloud software solutions platform is rapidly evolving, which means that the level of acceptance of the platform will take time to determine. If customer acceptance fails to develop or develops slower than anticipated, current operations and growth opportunities are likely to diminish.

Shareholder Control

Officers and directors of Intellinetics Inc. own or have a controlling interest in of approximately 27.7% of the outstanding voting stock as of the company's April 2019 proxy filing. The company's officers include Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. who was appointed Chairman of INLX in October 2017 and owns or has a controlling interest in 7.9% of the company's outstanding voting stock. Two shareholders, Michael Taglich (President of Taglich Brothers, Inc.) and Robert Taglich (Managing Director of Taglich Brothers, Inc.) collectively own or have a controlling interest in nearly 60.7% of the outstanding voting stock as of the April 2019 SEC filing. This could potentially influence the outcome of matters requiring stockholder approval, which decisions may or may not be in the best interests of the other shareholders.

Miscellaneous Risk

The company's financial results and equity values are subject to other risks and uncertainties, including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Trading Volume

Based on our calculations, the average daily-volume in 2017 was 13,900 shares, which decreased to 5,300 in 2017. During the last three months to August 21, 2019, volume decreased to 1,400. The company has a float of 8.5 million shares and shares outstanding of 18.5 million.

Intellinetics Inc.
Consolidated Balance Sheets
FY2016A – FY2020E
(in thousands)

	FY16A	FY17A	FY18A	2Q19A	**FY19E**	**FY20E**
ASSETS						
Current assets:						
Cash	$ 690	$ 1,126	$ 1,089	$ 412	**$ 229**	**$ 44**
Accounts receivable, net	259	295	136	174	**149**	**160**
Prepaid expense and other current assets	151	162	162	144	**150**	**155**
Total current assets	1,100	1,584	1,387	730	**528**	**360**
Property and equipment, net	19	15	9	11	**12**	**12**
Right of use asset	-	-	-	118	**118**	**118**
Other assets	10	10	10	10	**10**	**10**
Total assets	$ 1,129	$ 1,609	$ 1,406	$ 868	**$ 668**	**$ 500**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Accounts payable and accrued expenses	767	405	308	292	**700**	**1,150**
Lease liability	-	-	-	22	**22**	**22**
Deferred revenues	665	708	724	588	**600**	**1,000**
Deferred compensation	215	213	165	141	**141**	**175**
Notes payable	360	875	-	-	**3,292**	**190**
Notes payable - related party	38	417	47	24	**858**	**190**
Total current liabilities	2,046	2,618	1,244	1,067	**5,613**	**2,727**
Notes payable	586	1,221	3,145	3,242	**-**	**3,242**
Notes payable - related party	299	313	1,046	1,076	**418**	**1,276**
Lease liability	-	-	-	101	**105**	**105**
Deferred interest expense	158	-	-	-	**-**	**-**
Other long-term liabilities - related parties	1	100	502	845	**845**	**1,000**
Stockholders' equity:						
Common stock, $0.001 par value; authorized 50,000,000 shares;	27	30	31	32	**32**	**32**
Additional paid-in capital	12,966	13,649	14,101	14,313	**14,476**	**14,851**
Retained earnings (accumulated deficit)	(14,955)	(16,323)	(18,663)	(19,806)	**(20,821)**	**(22,733)**
Total stockholders' equity	(1,962)	(2,644)	(4,531)	(5,462)	**(6,313)**	**(7,850)**
Total liabilities and stockholders' equity	$ 1,129	$ 1,609	$ 1,406	$ 868	**$ 668**	**$ 500**
SHARES OUT	16,816	17,427	17,729	18,525	**18,535**	**18,550**

Source: Company reports and Taglich Brothers estimates

Intellinetics Inc.
Annual Income Statement
FY2016A – FY2020E
(in thousands)

	FY16 A	FY17 A	FY18 A	**FY19 E**	**FY20 E**
Sale of software	$ 391	$ 452	$ 174	**$ 29**	**$ 80**
Software-as-a-service (SaaS)	525	622	749	**934**	**1,415**
Software maintenance services	989	966	995	**1,000**	**1,050**
Professional services	503	452	290	**434**	**600**
Third party services	194	128	174	**38**	**60**
Total Revenues	$ 2,602	$ 2,620	$ 2,381	**$ 2,436**	**$ 3,205**
Cost of Revenues per segement					
Sale of software	74	98	70	**13**	**20**
Software-as-a-service (SAAS)	248	305	300	**263**	**390**
Software maintenance services	128	120	100	**90**	**100**
Professional services	135	198	120	**153**	**200**
Third party services	125	39	152	**34**	**48**
Total Cost of sales	710	760	742	**554**	**758**
Gross Profit	1,892	1,860	1,639	**1,882**	**2,447**
Operating Expenses:					
General and administrative	2,119	2,200	2,107	**2,115**	**2,220**
Sales and marketing	1,132	823	998	**950**	**1,050**
Depreciation	11	12	9	**8**	**4**
Total Operating Expenses	3,262	3,034	3,114	**3,073**	**3,274**
Operating Income (loss)	(1,370)	(1,175)	(1,475)	**(1,191)**	**(827)**
Other income (expense)					
Interest income (expense)	(206)	(610)	(866)	**(967)**	**(1,085)**
Total Other Income (expense)	(206)	(191)	(866)	**(967)**	**(1,085)**
Pre-Tax Income (loss)	(1,576)	(1,365)	(2,340)	**(2,159)**	**(1,912)**
Income Tax Expense (Benefit)	-	-	-	**-**	**-**
Net income (loss)	(1,576)	(1,365)	(2,340)	**(2,159)**	**(1,912)**
Earning (loss) per share	$ (0.09)	$ (0.08)	$ (0.13)	**$ (0.12)**	**$ (0.10)**
Avg Shares Outstanding	16,650	17,373	17,726	**18,520**	**18,565**
Adjusted EBITDA	$ (1,142)	$ (944)	$ (1,159)	**$ (534)**	**$ (227)**
Margin Analysis					
Gross margin - Sale of software	81.2%	78.4%	59.8%	**54.9%**	**75.0%**
Gross margin - SAAS	52.8%	51.1%	59.9%	**71.8%**	**72.4%**
Gross margin - Maintenance services	87.1%	87.5%	89.9%	**91.0%**	**90.5%**
Gross margin - Professional services	73.1%	56.1%	58.5%	**64.7%**	**66.7%**
Gross margin - Third Party services	35.6%	69.1%	12.7%	**10.9%**	**20.0%**
Total gross margin	72.7%	71.0%	68.8%	**77.3%**	**76.3%**
General and administrative	81.4%	84.0%	88.5%	**86.8%**	**69.3%**
Sales and marketing	43.5%	31.4%	41.9%	**39.0%**	**32.8%**
Depreciation	0.4%	0.5%	0.4%	**0.3%**	**0.1%**
Operating margin	(52.7%)	(44.8%)	(61.9%)	**(48.9%)**	**(25.8%)**
Pre-tax margin	(60.6%)	(52.1%)	(98.3%)	**(88.6%)**	**(59.7%)**
Tax rate	0.0%	0.0%	0.0%	**0.0%**	**0.0%**
YEAR / YEAR GROWTH					
Total Revenues	11.3%	0.7%	(9.1%)	**2.3%**	**31.6%**

Source: Company reports and Taglich Brothers estimates

Intellinetics Inc.
Income Statement Model
Quarters 2018A – 2020E
(in thousands)

	Q1 18 A	Q2 18 A	Q3 18 A	Q4 18 A	FY18 A	Q1 19 A	Q2 19 A	Q3 19 E	Q4 19 E	**FY19 E**	Q1 20 E	Q2 20 E	Q3 20 E	Q4 20 E	**FY20 E**
Sale of software	$ 41	$ 34	$ 65	$ 34	$ 174	$ 2	$ 7	$ 10	$ 10	**$ 29**	$ 20	$ 20	$ 20	$ 20	**$ 80**
Software-as-a-service (SaaS)	177	178	174	221	749	199	230	235	270	**934**	305	335	375	400	**1,415**
Software maintenance services	244	245	252	255	995	253	253	245	250	**1,000**	255	260	265	270	**1,050**
Professional services	59	53	57	121	290	52	143	120	120	**434**	150	150	150	150	**600**
Third party services	5	40	126	3	174	10	8	10	10	**38**	15	15	15	15	**60**
Total Revenues	$ 525	$ 550	$ 673	$ 633	$ 2,381	515	641	620	660	**$ 2,436**	$ 745	$ 780	$ 825	$ 855	**$ 3,205**
Cost of Revenues per segement															
Sale of software	18	13	34	5	70	2	1	5	5	**13**	5	5	5	5	**20**
Software-as-a-service (SAAS)	77	69	75	79	300	68	61	60	75	**263**	85	95	100	110	**390**
Software maintenance services	26	25	24	26	100	29	21	20	20	**90**	25	25	25	25	**100**
Professional services	17	19	22	62	120	34	40	40	40	**153**	50	50	50	50	**200**
Third party services	10	34	107	1	152	10	8	8	8	**34**	12	12	12	12	**48**
Total Cost of sales	148	160	262	173	742	142	130	133	148	**554**	177	187	192	202	**758**
Gross Profit	378	390	411	460	1,639	373	511	487	512	**1,882**	568	593	633	653	**2,447**
Operating Expenses:															
General and administrative	543	593	446	524	2,107	539	521	525	530	**2,115**	540	550	560	570	**2,220**
Sales and marketing	262	244	236	256	998	269	222	225	235	**950**	240	255	265	290	**1,050**
Depreciation	2	2	2	2	9	2	2	2	2	**8**	1	1	1	1	**4**
Total Operating Expenses	807	840	685	782	3,114	810	745	752	767	**3,073**	781	806	826	861	**3,274**
Operating Income (loss)	(430)	(450)	(273)	(322)	(1,475)	(437)	(234)	(265)	(255)	**(1,191)**	(213)	(213)	(193)	(208)	**(827)**
Other income (expense)															
Interest income (expense)	(209)	(219)	(207)	(231)	(866)	(233)	(239)	(245)	(250)	**(967)**	(260)	(265)	(275)	(285)	**(1,085)**
Total Other Income (expense)	(209)	(219)	(207)	(231)	(866)	(233)	(239)	(245)	(250)	**(967)**	(260)	(265)	(275)	(285)	**(1,085)**
Pre-Tax Income (loss)	(639)	(669)	(480)	(552)	(2,340)	(670)	(474)	(510)	(505)	**(2,159)**	(473)	(478)	(468)	(493)	**(1,912)**
Income Tax Expense (Benefit)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(639)	(669)	(480)	(552)	(2,340)	(670)	(474)	(510)	(505)	**(2,159)**	(473)	(478)	(468)	(493)	**(1,912)**
Earning (loss) per share	$ (0.04)	$ (0.04)	$ (0.03)	$ (0.03)	$ (0.13)	$ (0.04)	$ (0.03)	$ (0.03)	$ (0.03)	**$ (0.12)**	$ (0.03)	$ (0.03)	$ (0.03)	$ (0.03)	**$ (0.10)**
Avg Shares Outstanding	17,719	17,729	17,729	17,727	17,726	18,480	18,525	18,535	18,540	**18,520**	18,550	18,560	18,570	18,580	**18,565**
	-					0									
Adjusted EBITDA	$ (308)	$ (385)	$ (209)	$ (257)	$ (1,159)	$ (215)	$ (90)	$ (120)	$ (110)	**$ (534)**	$ (63)	$ (63)	$ (43)	$ (58)	**$ (227)**
Margin Analysis															
Gross margin - Sale of software	56.4%	62.9%	48.1%	83.7%	59.8%	(5.5%)	83.6%	50.0%	50.0%	**54.9%**	75.0%	75.0%	75.0%	75.0%	**75.0%**
Gross margin - SAAS	56.3%	61.4%	56.6%	64.1%	59.9%	66.0%	73.7%	74.5%	72.2%	**71.8%**	72.1%	71.6%	73.3%	72.5%	**72.4%**
Gross margin - Maintenance services	89.5%	89.8%	90.5%	89.9%	89.9%	88.4%	91.9%	91.8%	92.0%	**91.0%**	90.2%	90.4%	90.6%	90.7%	**90.5%**
Gross margin - Professional services	71.5%	63.3%	61.1%	48.8%	58.5%	35.2%	72.1%	66.7%	66.7%	**64.7%**	66.7%	66.7%	66.7%	66.7%	**66.7%**
Gross margin - Third Party services	(94.7%)	15.2%	15.1%	67.1%	12.7%	1.0%	0.8%	20.0%	20.0%	**10.9%**	20.0%	20.0%	20.0%	20.0%	**20.0%**
Total gross margin	71.9%	71.0%	61.1%	72.6%	68.8%	72.4%	79.7%	78.5%	77.6%	**77.3%**	76.2%	76.0%	76.7%	76.4%	**76.3%**
General and administrative	103.4%	108.0%	66.3%	82.7%	88.5%	104.6%	81.3%	84.7%	80.3%	**86.8%**	72.5%	70.5%	67.9%	66.7%	**69.3%**
Sales and marketing	49.8%	44.5%	35.1%	40.4%	41.9%	52.1%	34.6%	36.3%	35.6%	**39.0%**	32.2%	32.7%	32.1%	33.9%	**32.8%**
Depreciation	0.4%	0.4%	0.4%	0.3%	0.4%	0.4%	0.3%	0.3%	0.3%	**0.3%**	0.1%	0.1%	0.1%	0.1%	**0.1%**
Operating margin	(81.8%)	(81.9%)	(40.6%)	(50.8%)	(61.9%)	(84.7%)	(36.6%)	(42.7%)	(38.6%)	**(48.9%)**	(28.6%)	(27.3%)	(23.4%)	(24.3%)	**(25.8%)**
Pre-tax margin	(121.5%)	(121.8%)	(71.3%)	(87.2%)	(98.3%)	(130.0%)	(73.9%)	(82.3%)	(76.5%)	**(88.6%)**	(63.5%)	(61.3%)	(56.7%)	(57.7%)	**(59.7%)**
Tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	**0.0%**	0.0%	0.0%	0.0%	0.0%	**0.0%**
YEAR / YEAR GROWTH															
Total Revenues	(25.8%)	(25.5%)	0.2%	25.7%	(9.1%)	(1.9%)	16.5%	(7.9%)	4.2%	**2.3%**	44.6%	21.8%	33.1%	29.5%	**31.6%**

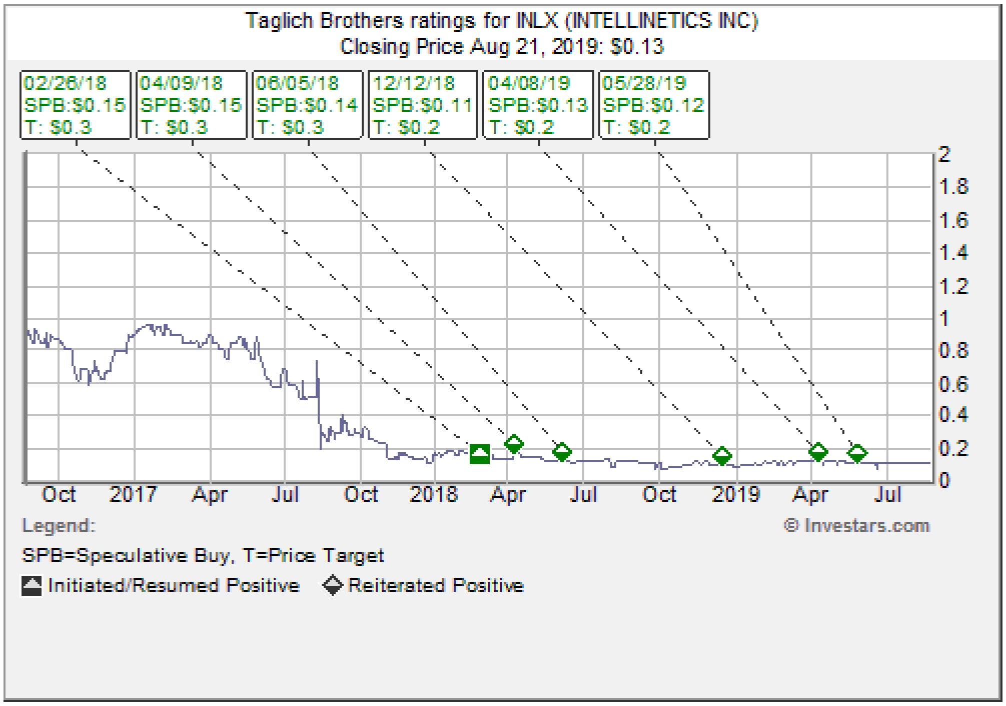
Source: Company reports and Taglich Brothers estimates

Intellinetics Inc.
Cash Flow Statement
FY2016A – FY2020E
(in thousands)

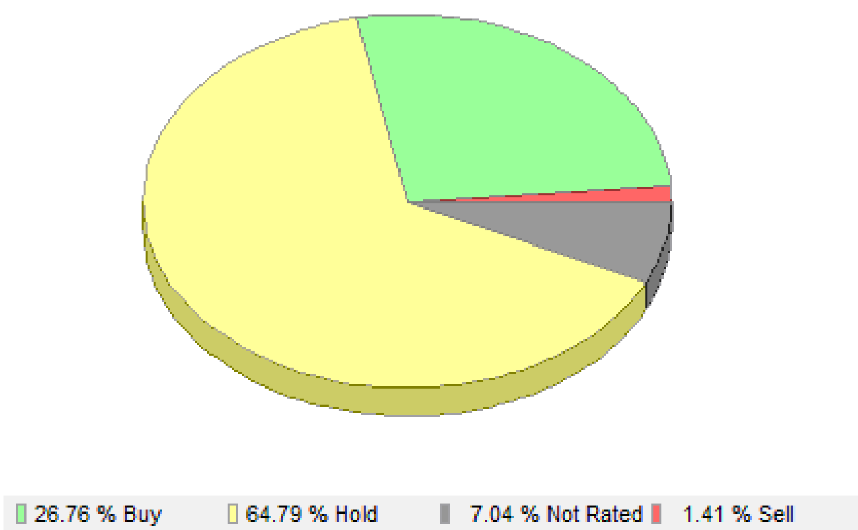
	FY2016A	FY2017A	FY2018A	6 Mos. 19A	**FY2019E**	**FY2020E**
Cash Flows from Operating Activities						
Net Income (loss)	$ (1,576)	$ (1,365)	$ (2,340)	$ (1,144)	**$ (2,159)**	**$ (1,912)**
Depreciation and amortization	11	12	9	4	**8**	**5**
Bad debt expense	23	4	(7)	4	**4**	**-**
Loss on disposal of fixed assets	-	5	-	-	**-**	**-**
Amortization of deferred financing costs	3	132	233	92	**184**	**-**
Amortization of beneficial conversion option	-	253	202	35	**70**	**140**
Gain on disposal of property and equipment	63	-	-	-	**-**	**-**
Amortization of right of use asset	-	-	-	21	**40**	**40**
Stock issued for services	138	66	58	88	**125**	**125**
Stock options compensation	138	153	249	125	**250**	**250**
Note conversion warrant expense	97	53	-	-	**-**	**-**
Gain on retirement of debt	-	(419)	-	-	**-**	**-**
Cash earnings (burn)	(1,104)	(1,107)	(1,597)	(775)	**(1,478)**	**(1,352)**
Changes In:						
Accounts receivable	(66)	(41)	167	(42)	**(13)**	**(11)**
Prepaid expenses and other current assets	(104)	(12)	(0)	19	**12**	**(5)**
Right of use asset	-	-	-	(139)	**(139)**	**-**
Accounts payable and accrued expenses	(25)	(96)	(97)	(16)	**392**	**450**
Other long-term liabilities - related parties	(12)	99	402	343	**343**	**155**
Lease liability	-	-	-	122	**122**	**-**
Deferred compensation	-	(2)	(48)	(24)	**(24)**	**34**
Deferred interest expense	22	(4)	-	-	**-**	**-**
Deferred revenues	27	39	15	(136)	**(124)**	**400**
(Increase)/decrease in Working Capital	(157)	(16)	440	127	**569**	**1,023**
Net cash Provided by Operations	(1,261)	(1,122)	(1,157)	(648)	**(908)**	**(329)**
Cash Flows from Investing Activities						
Purchase of property and equipment	(7)	(13)	(3)	(5)	**(5)**	**(5)**
Cash Flows from Investing Activities	(7)	(13)	(3)	(5)	**(5)**	**(5)**
Cash Flows from Financing Activities						
Sale of common stock	559	-	-	-	-	-
Exercise of stock options	3	-	-	-	-	-
Payment of deferred financing costs	(53)	(318)	(131)	-	-	-
Issuance of convertible notes	-	2,320	-	-	-	-
Proceeds (repayment) from notes payable, net	48	(786)	900	-	**100**	**200**
Proceeds (repayment) from notes payable - related party, net	282	355	354	(23)	**(47)**	**(50)**
Net cash provided by Financing	840	1,571	1,124	(23)	**53**	**150**
Net change in Cash	(427)	436	(37)	(676)	**(860)**	**(184)**
Cash Beginning of Period	1,117	690	1,126	1,089	**1,089**	**229**
Cash End of Period	$ 690	$ 1,126	$ 1,089	$ 412	**$ 229**	**$ 44**

Source: Company reports and Taglich Brothers estimates

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	2	9
Hold		
Sell		
Not Rated	1	25

Important Disclosures

As of August 21, 2019, Taglich Brothers, Inc. and/or its affiliates own or have controlling interests in more than 1% of INLX common stock. Michael Taglich, President of Taglich Brothers, Inc. owns or has a controlling interest in 2,815,544 shares of INLX common and restricted common stock and approximately 8,025,106 shares that may be acquired upon the conversion of convertible notes and exercise of restricted warrants. Robert Taglich, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 2,579,632 shares of INLX common and restricted common stock and approximately 4,703,677 shares that may be acquired upon the conversion of convertible notes and exercise of restricted warrants. Robert Schroeder, Vice President of Investment Banking at Taglich Brothers, Inc. and Chairman of Intellinetics Inc., owns or has a controlling interest in 594,236 shares of INLX common and restricted common stock and 751,142 shares that may be acquired upon the conversion of convertible notes and exercise of restricted warrants. As of August 21, 2019, Doug Hailey, Director of Investment Banking at Taglich Brothers, Inc., owns or has a controlling interest in 28,571 shares of INLX restricted common stock and approximately 232,500 shares that may be acquired upon the exercise of restricted warrants. Richard Oh, Managing Director of Taglich Brothers, Inc., owns or has a controlling interest in 104,000 shares of INLX that may be acquired upon the exercise of restricted warrants. Taglich Brothers, Inc., owns or has a controlling interest in 24,124 shares of restricted common stock and 11,258 shares that may be acquired upon the exercise of restricted warrants. Other employees at Taglich Brothers, Inc. also own or have controlling interests in 423,640 shares of INLX that may be acquired upon the exercise of restricted warrants. Taglich Brothers, Inc. had an investment banking relationship with the company mentioned in this report. In March 2013, Taglich Brothers, Inc. served as the placement agent for a common stock offering. In 2014, the company retained Taglich Brothers, Inc. as a placement agent for the sale of convertible notes the transaction. In November and December 2016, and January 2017, Taglich Brothers Inc. served as the placement agent in the sale of 12% convertible notes for the company. In September and November 2017 and September 2018, Taglich Brothers, Inc. served as the placement agent in the sale of 8% convertible notes for the company. In September 2018, Taglich Brothers earned warrants to purchase 800,000 shares INLX common stock.

All research issued by Taglich Brothers, Inc. is based on public information. In January 2018, the company paid Taglich Brothers a monetary fee of $4,500 (USD) representing payment for the creation and dissemination of research reports for three months. In June 2018, the company began paying Taglich Brothers a monthly monetary fee of $1,500 (USD) for the creation and dissemination of research reports.

General Disclosures

The information and statistical data contained herein have been obtained from sources, which we believe to be reliable but in no way are warranted by us as to accuracy or completeness. We do not undertake to advise you as to changes in figures or our views. This is not a solicitation of any order to buy or sell. Taglich Brothers, Inc. is fully disclosed with its clearing firm, Pershing, LLC, is not a market maker and does not sell to or buy from customers on a principal basis. The above statement is the opinion of Taglich Brothers, Inc. and is not a guarantee that the target price for the stock will be met or that predicted business results for the company will occur. There may be instances when fundamental, technical and quantitative opinions contained in this report are not in concert. We, our affiliates, any officer, director or stockholder or any member of their families may from time to time purchase or sell any of the above-mentioned or related securities. Analysts and members of the Research Department are prohibited from buying or selling securities issued by the companies that Taglich Brothers, Inc. has a research relationship with, except if ownership of such securities was prior to the start of such relationship, then an Analyst or member of the Research Department may sell such securities after obtaining expressed written permission from Compliance.

Analyst Certification

I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

Public Companies mentioned in this report:

Intel Corporation (NASDAQ: INTC)

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long-term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company-specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.